

Gokaldas Exports

STOCK INFO. BLOOMBERG
BSE Sensex: 7,992 GOKL IN
REUTERS CODE
S&P CNX: 2,418 GOKL. BO

25 October 2005

Buy

Rs516

Previous Recommendation: Buy

Equity Shares (m) 17.2
52-Week Range (Rs) 714/469
1,6,12 Rel.Per. (%) 4/-45/NA
M.Cap (Rs. b) 8.9
M.Cap (US\$ b) 0.2

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
3/05A	7,241	398	28.3	2.8	18.2	3.7	23.7	15.8	1.4	16.3
3/06E	8,644	542	31.6	11.5	16.4	2.4	19.1	14.4	1.0	11.4
3/07E	10,511	725	42.2	33.8	12.2	2.0	17.9	15.2	0.8	9.2

- Gokaldas reported net profit of Rs185m in 2QFY06 in line with our estimates of Rs183m. Being the first year of listing comparable quarterly numbers for the corresponding period are not available. PAT for 1HFY06 at Rs301m, registered a 22% YoY growth.
- Revenues during 2QFY06 stood at Rs2.4b. The management said that it has orders of Rs2.5b in hand scheduled for delivery before December 2005 and foresees a robust order book for 4QFY06.
- EBITDA margins for 2QFY06 stood at 10.7%, an improvement over FY05 EBITDA margin of 8.6%. PAT margins during 2QFY06 also stood at a robust 7.5%.
- Gokaldas added 3,814 people during 1HQFY06 to take its total employee strength to 37,756 people. The management has often indicated that lack of labour flexibility in the country is acting as a major deterrent to its effort to achieve aggressive growth.
- Gokaldas has also managed to de-risk itself by bringing down its dependence on GAP from around 50% of revenues in FY05 to around 46% in 2QFY06.
- We expect Gokaldas to report revenue and earnings CAGR of 20% and 35%, respectively, over FY05-07. It trades at 16.4x FY06E and 12.2x FY07E earnings. We rate the stock a **Buy** with a price target of Rs635, an upside of 23.1%.

QUARTERLY PERFORMANCE

Y/E MARCH	FY06				FY05	(Rs Million)
	1Q	2Q	3QE	4QE		FY06E
Sales	1,790	2,471	2,049	2,335	7,240	8,644
Change (%)	na	na	na	na	35.1	19.4
EBITDA	179	265	166	182	619	791.7
Change (%)	na	na	na	na		27.8
As % of Sales	10.0	10.7	8.1	7.8	8.6	9.2
Depreciation	34	42	50	58	129	184
Interest	33	38	14	15	119	100
Other Income	8	5	21	50	105	85
PBT	120	190	124	159	439	593
Tax	4	5	16	25	41	50
Effective Tax Rate (%)	2.9	2.6	13.0	15.8	9.4	8.5
Reputed PAT	116	185	108	134	398	542
Adj. PAT	116	185	108	134	398	542
Change (%)	na	na	na	na	6.6	36.3

E: MOST Estimates

New capacities to drive strong growth

Gokaldas has guided for growth rates in the range of 15-20%, going forward. This growth is likely to be driven by new capacity additions. The management has already started production and stabilized its three new facilities, which were successfully commissioned during May-July 2005. The company's current capacity stands at around 2m garments per month, which is likely to increase to 2.4m pieces by March 2006. The company is in the midst of implementing several new capacities, which is likely to further aid growth.

Capex under implementation

- ✍ The construction work at the Chennai SEZ unit has started during 2QFY06.
- ✍ A new state-of-the-art laundry facility is being set up in Bangalore to take care of the washing requirements of various products like trousers and denim jeans. The 70,000 sq. ft. facility is under construction and is expected to start operations by April 2006.
- ✍ The jeans plant at Doddaballapur has commenced operations and the management is planning to add 90,000 sq. feet of space to this unit to increase its production capacity to 1.2m units per annum.
- ✍ The Yelahanka unit (Venkateswara Clothing Company) is being expanded and a space of 120,000 sq. feet being built. The additional facilities would also manufacture jeans and trousers.

Tax rates to continue to remain low

Gokaldas enjoys several tax exemptions, due to the EoU status of its plants. Hence, it is likely to pay minimum taxes over FY06-09. Further, it is setting up a new plant at Chennai, which is located in a SEZ unit. This plant enjoys significant fiscal incentives, which includes income tax exemptions for 15 years. We believe, that its investment in the SEZ unit would ensure that the company continues to enjoy zero to very low tax paying status for several years even beyond FY06-09.

Client concentration coming down

One of the key perceived risks in Gokaldas has been its high client concentration, with GAP alone accounting for half its revenues in FY05 and top five clients accounting for almost 78% of sales in FY05. However, during 2QFY06, the company managed to reduce its dependence on GAP to 46%, compared to 50% in FY05. The company is continuously bringing down its dependence on GAP by adding new clients. During 2QFY06, the company added several new large clients to its portfolio such as Macy's, NEXT, Abercrombie etc.

GAP outsources close to US\$6b globally and operates under three sub brands such as Old Navy, Banana Republic and GAP, which operate independently on their own. GAP has a stated target of increasing its outsourcing from India to close to US\$1b over the next two to three years. We believe that Gokaldas, with its strong relationship with GAP, is ideally placed to leverage on this opportunity. Hence, we do not view Gokaldas's high dependence on GAP negatively.

Benefit from embargoes on China

China exports close to US\$60b of apparels, while Indian exports stand at US\$6b. Going forward, China's high growth rates in the textile industry is likely to be limited to 10-12% due to the imposition of embargoes from countries such as USA and EU. India is expected to benefit substantially from embargoes on China by the US and EU. We believe, Gokaldas is best placed to be able to leverage on this huge opportunity.

Pricing pressure to abate

Going forward, the management has indicated that they are looking at low pricing pressure and a stable industry pricing environment ahead. This has been largely facilitated by the imposition of embargos against China by USA and EU, which is forcing large retailers to de-risk themselves from their high dependence on China.

High probability of labour reforms soon

Industry participants suggest that the government is likely to allow labour flexibility in EOUs and SEZs very soon. Gokaldas, with a total employee strength of 37,756 people in 1HFY06, has often indicated that lack of labour reforms in the country is acting as a major deterrent to its aggressive growth plans. We believe that any progress on the labour reform front would be a huge boon for the Indian garment industry and Gokaldas, in particular.

Valuation and view

Gokaldas Exports is one of the best proxies for the quota outsourcing story in the Indian textiles sector. It is one of the largest and most respected garment manufacturers in India. We anticipate sharp improvements in productivity levels aided by longer runs, implementation of modern scientific shop floor management techniques and increased mechanization.

We expect the company to register revenue CAGR of 20% and profit CAGR of 35% over FY05-07. It trades at 16.4x FY06E and 12.2x FY07E earnings. We rate the stock a **Buy** with a price target of Rs635, an upside of 23.1%.

Gokaldas Exports: an investment profile

Company description

Gokaldas Exports is one of the best proxies for the quota outsourcing story in the Indian textiles sector. It is one of the largest and most respected garment manufacturers in India. It has world-class capacities and has established relationships with major international retailers and buyers, which, we believe, it can leverage to its advantage in the post-quota era.

Key investment arguments

- ✍ 'Preferred vendor' for some of the world's largest brands.
- ✍ Global sourcing capabilities and integrated facilities.
- ✍ Superior design capabilities.
- ✍ Specialization in outerwear enables it to earn higher margins.
- ✍ High non-quota country sales.

Key investment risks

- ✍ High dependence on GAP.
- ✍ Margins under pressure.
- ✍ Differential tariffs to be a crucial issue.
- ✍ Constricting labor laws.

Recent developments

- ✍ Has expanded capacity to 296 lines.
- ✍ Plans to set up two factories in FY06 and change its product mix to cover all categories.
- ✍ Likely to benefit substantially from safeguard measures against China by USA and EU.

Valuation and view

- ✍ Expected to register revenue and PAT CAGR of 20% and 35%, over FY05-07.
- ✍ It trades at 16.4x FY06E and 12.2x FY07E earnings. We rate the stock a **Buy** with a price target of Rs635, an upside of 23.1%.

Sector view

- ✍ Exports from China are likely to be severely constrained due to safeguard measures imposed by the US and EU.
- ✍ India registered robust export growth rates to the US and EU in the post-quota era.
- ✍ Global buyers are focusing on building vendor partners who have high product development skills.
- ✍ Concern of industry overcapacity causing waves of deflation in prices is overblown.

COMPARATIVE VALUATIONS

		GOKALDAS	WELSPUN	VARDHMAN
P/E (x)	FY06E	16.4	15.1	10.4
	FY07E	12.2	8.8	9.2
P/BV (x)	FY06E	2.4	1.7	1.8
	FY07E	2.0	1.4	1.5
EV/Sales (x)	FY06E	11.4	2.1	1.2
	FY07E	9.2	1.5	1.1
EV/EBITDA (x)	FY06E	12.2	9.8	7.2
	FY07E	9.5	7.1	6.3

SHAREHOLDING PATTERN (%)

	SEP05	JUN.05
Promoters	76.9	76.9
Domestic Institutions	5.8	8.1
FII's/FDIs	3.6	2.0
Others	13.7	13.0

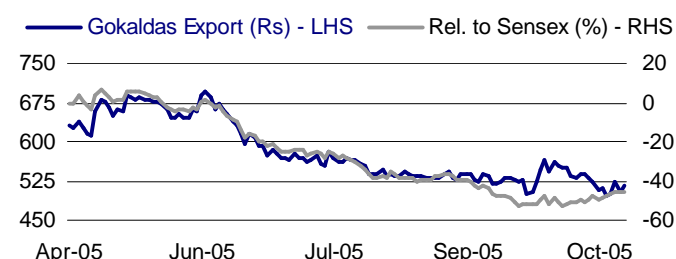
EPS: INQUIRE FORECAST VS CONSENSUS (RS)

	INQUIRE FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY06	31.6	-	-
FY07	42.2	-	-

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
516	635	23.1	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT (Rs Million)				
Y/E MARCH	2004	2005	2006E	2007E
Net Sales	5,361	7,240	8,644	10,511
Change (%)	14.5	35.1	19.4	216
Expenditure				
Employee Cost	968	1,134	1,360	1,698
Other Manuf. Expenses	292	577	664	763
Admin. & Other Expenses	193	253	303	368
Total Expenditure	4,918	6,621	7,853	9,536
EBITDA	525	619	792	975
Change (%)	17.3	17.9	27.8	23.1
% of Net Sales	9.8	8.6	9.16	9.3
Depreciation	107	129	184	210
EBIT	418	490	608	765
Interest & Finance Charges	76	119	100	44
Other Income	34	105	85	85
PBT	376	439	593	806
Tax	3	41	50	81
Effective Rate (%)	0.7	9.4	8.5	10.0
Reported PAT	373	398	542	725
Change (%)	7.8	6.6	36.3	33.8
Adjusted PAT	373	398	542	725

BALANCE SHEET (Rs Million)				
Y/E MARCH	2004	2005	2006E	2007E
Equity Capital	136	141	172	172
Share Capital	136	141	172	172
Reserves	1,281	1,807	3,568	4,176
Net Worth	1,417	1,948	3,740	4,347
Loans	1,241	1,481	1,131	681
Deferred Tax Liability	43	66	78	98
Capital Employed	2,700	3,494	4,949	5,127
Gross Fixed Assets	1,196	1,666	2,166	2,466
Less: Depreciation	364	493	678	887
Net Fixed Assets	832	1,173	1,489	1,579
Capital WIP	0	0	0	0
Investments	1	1	1	1
Curr. Assets	2,333	2,969	4,278	4,566
Inventory	1,466	1,977	2,345	2,848
Sundry Debtors	248	337	403	490
Cash & Bank Balances	308	234	1,011	616
Loans & Advances & Other Cur	312	421	519	613
Current Liab. & Prov.	467	660	818	1,020
Sundry Creditors	467	660	818	1,020
Net Current Assets	1,867	2,310	3,460	3,547
Application of Funds	2,700	3,494	4,949	5,127

E: M OSt Estimates

RATIOS				
Y/E MARCH	2004	2005E	2006E	2007E
Basic (Rs)				
EPS	27.5	28.3	31.6	42.2
Cash EPS	35.4	37.5	42.3	54.4
Book Value per Share	104.4	138.5	217.6	253.0
DPS	0.0	0.0	4.0	5.0
Payout (Incl. Div. Tax) %	0.0	0.0	14.5	16.2
Valuation (x)				
P/E	18.7	18.2	16.4	12.2
Cash P/E	14.6	13.8	12.2	9.5
EV/EBITDA	18.7	16.3	11.4	9.2
EV/Sales	1.8	1.4	1.0	0.8
Price to Book Value	4.9	3.7	2.4	2.0
Dividend Yield (%)	0.0	0.0	0.8	1.0
Profitability Ratios (%)				
RoE	22.8	23.7	19.1	17.9
RoCE	17.0	15.8	14.4	15.2
Turnover Ratios				
Debtors (Days)	17	17	17	17
Inventory (Days)	109	109	109	109
Creditors (Days)	52	55	52	52
Working Capital (Days)	127	116	146	123
Asset Turnover (x)	2.0	2.1	1.7	2.1
Fixed Asset Turnover (x)	4.5	4.3	4.0	4.3
Leverage Ratio				
Debt/Equity (x)	0.9	0.8	0.3	0.2

CASH FLOW STATEMENT (Rs Million) :s Million)				
Y/E MARCH	2004	2005E	2006E	2007E
PBT before E.O. Items	376	439	593	806
Add : Depreciation	107	129	184	210
Interest	76	119	100	44
Less : Direct taxes paid	3	41	50	81
(Inc)/Dec in WC	-445	-516	-373	-482
CF from operations	2	-35	281	388
Minority Interest & share of as:	0	0	0	0
CF from operations inclu	2	-35	281	388
(Inc)/dec in FA	-291	-470	-500	-300
(Pur)/Sale of Investments	0	0	0	0
CF from investments	-291	-470	-500	-300
(Inc)/Dec in Shares	29	-165	-1,328	0
(Inc)/Dec in Debt	-125	-240	350	450
Less : Interest Paid	76	119	100	44
Dividend Paid	0	32	78	118
CF from Fin. Activity	130	431	997	-483
Inc/Dec of Cash	-159	-74	777	-395
Add: Beginning Balance	467	308	234	1,011
Closing Balance	308	234	1,011	616

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Disclosure of Interest Statement

Gokaldas Exports

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| 1. Analyst ownership of the stock | No |
| 2. Group/Directors ownership of the stock | No |
| 3. Broking relationship with company covered | No |

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